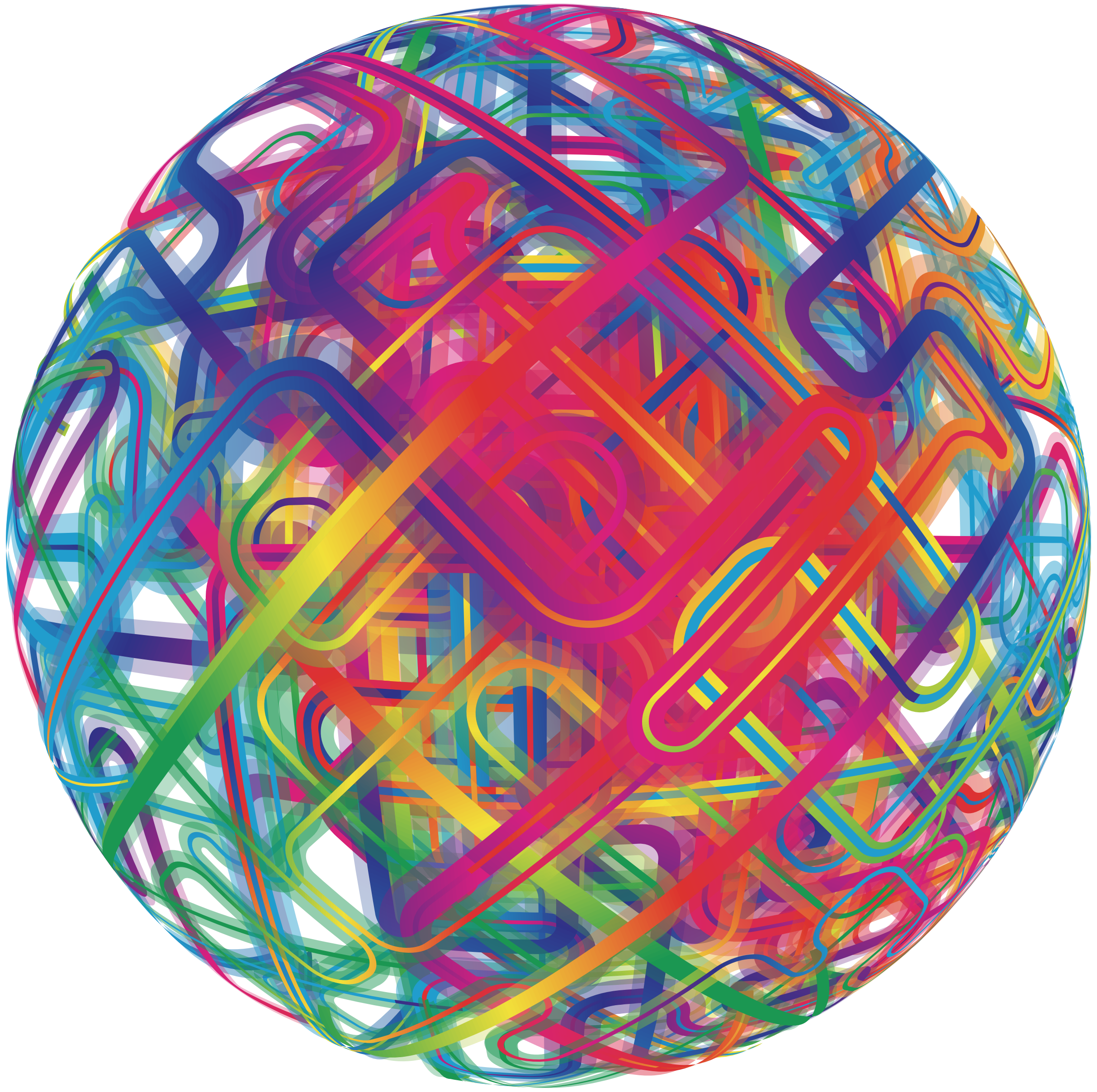
Technical

Integrated reporting demystified



Integrated reporting could improve annual reports by reflecting a range of value-adding activities.

BY JUDITH WYLIE & ANNE MARIE WARD

Table 1: Integrated Reporting Framework

	Traditional reporting		Integrated reporting
Thinking	Disconnected	→	Integrated
Stewardship	Financial capital	→	All forms of captial
Focus	Past financial	→	Past and future connect, strategic
Time frame	Short-term	→	Short, medium and long-term
Trust	Narrow Disclosures	→	Greater transparency
Adaptive	Rule-bound	→	Responsive to individual circumstance
Concise	Long and complex	→	Concise and material
Technology	Paper-based	→	Technology-enabled

The way companies do business has changed dramatically over the past few decades. In the current business world, investment in tangible assets is no longer a key indicator of a potential for value creation; intangible assets are now the main value drivers in many companies. Other non-financial factors also provide information on a company's potential for sustainable value creation, such as corporate social responsibility (CSR) activities and relationships with key stakeholders.

The opportunities, challenges and – in particular – the risks that arise from operating within a global, networked business environment are also much greater than they were in the past. A company's ability to adapt and evolve to gain competitive advantage are crucial to its long-term ability to sustain value creation. The problem with current annual reports, however, is that they simply do not reflect these value drivers. Where they do, they are more likely to be treated using a 'silo' approach which does not reflect the connectivity between, for example, CSR, the financials and sustainable value creation.

Integrated reporting (IR) is considered to be a solution. In this article, we explain IR; highlight the important role that Chartered Accountants play when a company decides to convert to IR; note the approach provided by the International Integrated Reporting Council (IIRC); outline how one company, Northern Ireland Water (NI Water), has approached IR; and identify some steps that might help an organisation get started.

> “” An integrated report is a concise communication about how an organisation's strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value in the short, medium and long-term.

What is IR?

Companies are increasingly making CSR disclosures in their annual reports. However, few have moved to full IR of activities. For example, although 90% of listed companies in the UK include some CSR reporting in their annual statements, only 9% of these companies refer to their accounts as integrated.

So what exactly is IR? The IIRC states that "an integrated report is a concise communication about how an organisation's strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value in the short, medium and long-term". The IIRC is a global coalition of regulators, investors, companies, standard setters, the accounting profession and non-governmental organisations (NGOs) whose mission is to "establish IR and thinking within mainstream business practice as the norm in the public and private sectors".

IR and the Chartered Accountant

IR is becoming increasingly important for Chartered Accountants. The Financial Reporting Council's (FRC) 'Clear & Concise' initiative aims to provide higher quality, cohesive annual reports that improve transparency and trust in business overall. As part of this initiative, the FRC started a consultation on 15 August 2017 on the contents of the strategic report section of annual reports, suggesting that they should contain "information relating to sources of value that have not been recognised in the financial statements and how those sources of value are managed, sustained and developed". In addition, recent legislation has mandated the disclosure of non-financial information. The European Union (Disclosure of Non-Financial and Diversity Information by Certain Large Undertakings and Groups) Regulation 2017 was brought into force in January 2017 for UK-based firms and in August 2017 for Irish firms. Approximately 6,000 companies will be required to disclose in their annual reports, information on:

- Policies, risks, and outcomes regarding environmental, social, and employee issues;
- Human rights;
- Anticorruption and bribery topics;
- The diversity of their board of directors.

Indeed, Paul Druckman, CEO of the IIRC has stated that "IR is the domain of the accountant more than other professions... the judgement and analytical skills inherent in the accountancy profession are key". Although the successful application of IR by definition requires input from different parts of an organisation, such as human resources, marketing and operations, in practice the actual integration of the information with the financials will often fall to the company accountant or to consultant accountants. Therefore, given the fundamental role accountants play in IR, they must equip themselves with new skills. However, unlike the reporting of financial information, there is little guidance on what should be communicated and how it is to be communicated. As a result, IR has attracted criticism from academics and practitioners alike, both of whom have questioned the objectivity and practicability of IR.

IR: a new mind-set

In response to the criticisms, the IIRC in conjunction with a number of reporting bodies such as the Financial Accounting Standards Board, the Global Reporting Initiative and the International Accounting Standards Board, developed an Integrated Reporting Framework. The aim of the framework is to provide greater coherence, consistency and comparability between corporate reporting frameworks, standards and requirements in relation to non-financial disclosures. The framework recommends a distinct approach for IR – refer to Table 1.

> "" Many organisations are doing great things in terms of social, environmental, ethical and philanthropic activities, yet have stopped short of formally collating, reviewing, measuring and reporting on the outcomes of such activities.

Central to IR, however, is linking these elements into the value-creation process. IR is more than just combining the disclosure of financial information and non-financial information into one single document. It requires a new way of thinking about how a business operates. Instead of narrowly focusing on creating shareholder value from financial capital, a wider view is required, one that recognises the various forms of capital resource available to the business including financial, intellectual, human, social and natural capital and the utilisation of that capital to create shared value for a range of stakeholders.

NI Water

When it comes to reporting on CSR activities in particular, NI Water is one of a small but increasing number of organisations that have moved towards IR to help capture the value and impact these activities have. NI Water uses IR to discharge its accountability in respect of its non-financial performance to its various stakeholders.

So, how has NI Water approached measuring and reporting on shared value creation? Keith Scott FCA, IR lead for NI Water, explains that by using IR, "what you're trying to do is much more forward looking and much wider than just the financial resources... it's about telling the story of how you're building long-term sustainable value... the challenge isn't necessarily to convert everything to financial terms, but it's more how you tell that story as to how you're managing all your resources and how you're adding value on a sustainable basis".

NI Water's reporting on non-financial issues has developed through a business-input-process-output model designed to track all internal resources, including CSR activities, and how they add value year-on-year in relation to the overall NI Water strategy (refer to Table 2).

A key aspect of NI Water's approach is the identification, measurement and reporting of strategic performance indicators (SPI). The company reports its SPI targets, highlights how it has performed, and uses traffic-light visual indicators to capture overall performance. A green thumbs-up is included when they have met or have exceeded the target and a red thumbs-down identifies areas where the target has not been met. The company also uses visual aids such as infographics in its annual report to explain how it adds value to the local economy, its key business activities, its financing, and to portray links between customer promises, the SPIs and its risks and opportunities. Finally, to assist understandability, the notes to the financial statements are grouped under key themes.

Recommended approach to IR

Chartered Accountants should benchmark practice in their own company to companies such as NI Water. Many organisations are doing great things in terms of social, environmental, ethical and philanthropic activities, yet have stopped short of formally collating, reviewing, measuring and reporting on the outcomes of such activities. It can be difficult to know where to start. The IIRC provides some guidance on steps to take when establishing IR including:

- Identify champions: IR needs internal champions with sufficient commitment and interest to make it work;
- Take a multidisciplinary approach: potential participants could come from finance, sustainability, strategy, governance, HR and investor relations teams;
- Clarify the audience: decide who the audience is – shareholders and potential investors or a wider range of stakeholders;
- Determine materiality processes: determine what aspects of value creation are most relevant to your intended audience and explain in the integrated report how decisions about materiality are made;
- Activate the data: include a summary of the key non-financial performance metrics in the front of the report to give an early overview of the organisation's overall performance. Disclose your targets, even where you may have missed them. Include prior year comparatives where they are available and explain any changes in measures;
- Use appropriate language: avoid technical or organisational jargon and use a neutral, factual tone;
- Demonstrate board commitment: show how integrated thinking and reporting are being driven from the top of the organisation; and
- IR is a journey: stakeholders need to understand that IR will naturally evolve over time.

They say a journey begins with a single step. For IR, the challenge may be bringing many steps into line and ensuring that each part of the business is marching in time and in the same direction. This is a challenging task, as is the measurement and monetisation of non-financial activities. However, there are rewards for companies who use IR in terms of employee retention, talent attraction, increased product and service innovation, environmental benefits, increased reputation and improved stakeholder satisfaction.

Governance will also be improved as the board will become more aware of all the valuable capital resources available to the company and how to utilise these to add value to the organisation, hence contributing to the company's long-term sustainable growth.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